

## Exhibit 11

Plaintiffs' Corrected Averment of Jurisdictional Facts and Evidence  
and/or Statement of Facts as to Defendant Al Rajhi Bank  
Pursuant to Rule 56.1

[REDACTED]

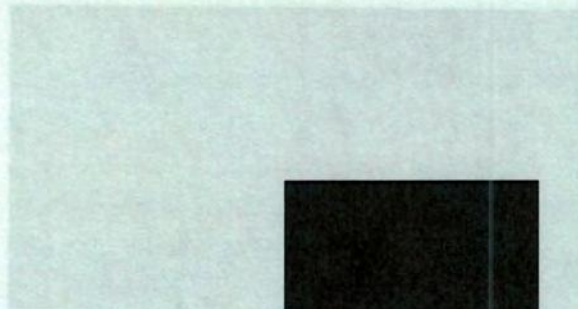


CENTRAL INTELLIGENCE AGENCY

DIRECTORATE OF INTELLIGENCE

21 May 2004

## Islamic Banking: A Potential Economic Enabler in the Muslim World [REDACTED]



[REDACTED]

[REDACTED]

### Islamic Banking: A Potential Economic Enabler in the Muslim World [REDACTED]

#### Key Findings (U)

Islamic banking (IB) is emerging as a significant player in the financial services sector of key Muslim countries and could be an avenue for the United States to sensitively and respectfully support economic development in these countries. Although key Islamic banks were found to be havens for terrorist financing in the wake of 9/11, tougher regulations and scrutiny on financial institutions worldwide have helped restore the core focus of these entities—providing financial services in keeping with the principles of Islamic law (*Sharia*), which forbids the payment of usury interest and other guaranteed financial returns.

- Initially fostered by governments of predominantly Muslim countries, IB is starting to be accepted by private banks and businesses and to flourish and move beyond niche status, as Muslims worldwide increasingly embrace religious tenets in daily life.
- IB has greatly benefited lower-income individuals and small-to-medium-size enterprises by offering service where often little to none existed previously. [REDACTED]

US support for IB could be a unique way to further financial intermediation in previously underserved Muslim countries and communities, particularly if it advanced the more moderate Malaysian model of IB. The finance initiatives in the Greater Middle East Initiative, particularly the microcredit facility, moreover, may gain more acceptability if they are based on IB principles. The Islamic Development Bank is a possible US partner in any endeavor to encourage IB.

- IB principles complement one of the goals of micro-finance programs—to provide collateral-free loans to small businesses and entrepreneurs, particularly to women.
- Promoting the growth of Islamic mortgages also may be an avenue to support economic and financial development in the Muslim world.
- The United States may be able to help enhance the integrity of the IB sector by sponsoring technical training on Know Your Customer standards that would benefit Islamic as well as conventional banks in these countries. [REDACTED]

Any US-led or endorsed initiative, however, would have to be undertaken cautiously to avoid being perceived as undermining the Islamic tenets of IB. [REDACTED]



## Islamic Banking: A Potential Economic Enabler in the Muslim World

### IB's Emergence on the Global Financial Scene (U)

Islamic banking (IB) began to flourish in the mid-1970s as oil-rich Gulf states flush with petrodollars looked to reassert their Islamic identities. IB gained real traction in the 1990s, growing at an estimated 10 to 15 percent per annum the last decade when governments in key Muslim countries actively endorsed and catalyzed expansion of these banking institutions. (See Appendix A.) Although still a relatively small player in the international financial system, IB is approaching critical mass in terms of geographic breadth, competitiveness, and product development.

- Estimates put the number of fully Islamic banks<sup>1</sup> at 200 to 270 in about 50 countries, according to press reports. (See Appendix B.)
- Most estimates put total Islamic banking assets at about \$260 billion—including about 10 percent of the major Gulf Arab states' total bank assets—and deposits at \$200 billion, but a leading industry expert in an interview said no one has a good sense of the size because the industry lacks accurate data (see chart).

<sup>1</sup> This paper emphasizes "fully" Islamic banks, those that adhere to *Sharia* in all of their procedures and operations. However, many conventional banks in Muslim countries also have Islamic "windows" offering Islamic products. In fact, some conventional banks hold more Islamic assets and deposits than some of their fully Islamic counterparts.

This assessment was prepared by the Office of Transnational Issues, with contributions from the Office of Near Eastern and South Asian Analysis and the Office of Terrorism Analysis. Comments and queries are welcome and may be directed to

### Islamic Banking Profile (U)

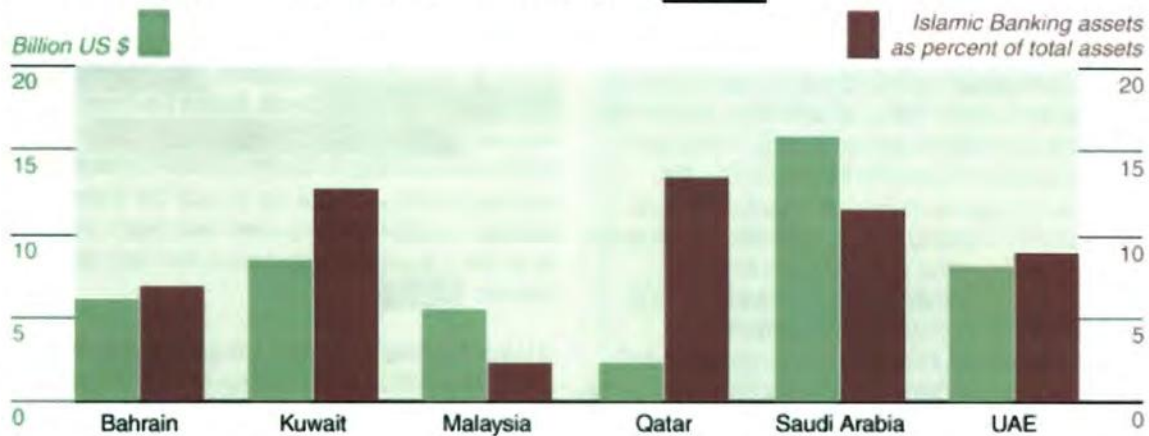
Islamic banking is a financial system conforming to Islamic law (*Sharia*) principles, which forbids the payment of usury interest, or *riba*, and other guaranteed returns on loans and investments. All transactions must be backed by tangible assets, and risk must be equally divided between the lender and borrower. The industry started to flourish in the 1970s when prominent Muslim scholars in the Gulf region began to actively promote a conservative interpretation of *Sharia* in relation to politics, economics, and finance.

- The concept of risk sharing between lender and borrower—known as *musharaka*—permits an Islamic banker to avoid the ban on charging interest by using invested capital for productive use rather than guaranteeing a fixed rate of return for money deposited in a bank; Islamic finance holds that there must be risk to justify a return.
- Islamic law prohibits investing in companies with high debt levels or those involved in military, gambling, tobacco, alcohol, or pork products.

### Political Push Gets the Ball Rolling (U)

Government-backed initiatives have been the greatest spur in spreading and expanding IB, and this support has played well domestically, filling a void for devout Muslims lacking appropriate financial vehicles.



**Islamic Banking Assets in Major IB Countries, 2002<sup>a</sup>**

<sup>a</sup>These numbers underrepresent the total amount of Islamic assets in the respective countries' banking systems, given they only include those held by fully Islamic banks and not the Islamic holdings of conventional banks.

Source: BankScope, Bank Negara Malaysia, Central Bank of the UAE, Saudi Arabian Monetary Authority, Central Bank of Kuwait, and Bahrain Monetary Agency. (U)

**CONFIDENTIAL//NOFORN****Bahrain and Malaysia Take the Lead. . .**

Bahrain has taken the leading role in promoting IB in the Middle East, hosting some 26 Islamic banks, the largest concentration in the world. The Bahrain Monetary Agency (BMA) spearheaded establishing a solid regulatory environment for Islamic banks and advocating uniform Islamic banking standards.

- Bahrain hosts the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic International Rating Agency that work to monitor and improve the operation of Islamic banks.
- Bahrain has raised almost \$1 billion, including a \$250-million asset-backed Islamic bond, or *sukuk*, issue in October 2003, hoping to reinforce its role as the hub of Islamic finance and international *sukuk* trading, according to the press.

Malaysia is Bahrain's main competitor in this arena and the leader of IB in Southeast Asia. During the past decade, the government established a sound infrastructure to support the sector that includes IB

laws, robust regulation and supervision, and an Islamic interbank money market. Earlier this year the central bank accelerated plans to issue three IB licenses to foreign banks.

- Malaysia played a pivotal role in establishing the Islamic Financial Services Board in November 2002—formed to develop a unified, international system of *Sharia*-compliant regulations and products; the secretariat is based in Kuala Lumpur.
- The government has issued many Islamic bonds, including the first global one in June 2002, and has proposed the inclusion of an Islamic bond in the Asian Bond Market, according to press reporting.
- A Malaysian finance ministry official claimed at the end of 2002 that roughly 40 percent of federal and local government funds and 30 percent of state and statutory bodies' funds were deposited in Islamic banks, according to the press.



### IB Not a Terrorist Financing Hotbed [REDACTED]

Although publicity about Islamic banks being havens for terrorist assets was widespread after 9/11, once tighter regulations and heightened scrutiny on financial institutions worldwide were put in place to guard against terrorist financial activities, high-profile Sunni Islamic extremist groups largely abandoned Islamic and conventional banks. Al-Qa'ida, the Zarqawi and Ansar al-Islam movements in Iraq, the Libyan Islamic Fighting Group, and others now move money via cash courier or trusted *hawalas*<sup>2</sup> for security reasons. Terrorists or their supporters will probably base any decision to use mainstream financial institutions to transfer funds on needs and security concerns rather than whether the institution is an Islamic bank or a conventional bank.

- Islamic banks were prominent vehicles for terrorist groups like al-Qa'ida, HAMAS, Egypt's al-Gama'at al-Islamiyya, and the Egyptian Islamic Group throughout the 1990s, when most countries did not have the laws and regulations in place to deter terrorists from using financial institutions.
- Management at Islamic institutions now employ better internal control procedures to ensure terrorists are not using their banks. [REDACTED]

Nevertheless, a few banks that operate under Islamic principles, such as the Al-Rajhi Banking and Investment Company in Saudi Arabia, are still of concern because of longtime use by al-Qa'ida operatives and other terrorists. The Saudi-based Bank al-Jazira and Saba Islamic Bank in Sanaa, Yemen, are also of concern because of their use by extremists.

- Some of the owners of these institutions—such as Shayks Suleiman al-Rajhi in Saudi Arabia and Salih al-Kamel and Abdul Majid Zindani in Yemen—reportedly have provided widespread funding to al-Qa'ida, HAMAS, and various mujahidin groups. [REDACTED]

<sup>2</sup> *Hawala* is a means of money transfer based on the use of connections, typically familial or regional affiliations, via telephone, fax, or email communications between *hawala* dealers, or *hawaladars*. (U)

### ...As Others Play Catch-Up

Political support for IB is growing in other Gulf countries. The Dubai International Financial Center, now under construction, made IB one of the chief pillars of its marketing plan and is trying to lure some banks to the UAE from Bahrain [REDACTED]. Saudi Arabia has been a notable laggard. [REDACTED] the Saudi Arabian Monetary Authority (SAMA) considered creating an Islamic banking system but feared such an attempt would expose conventional banks to charges from the religious establishment that they are un-Islamic. [REDACTED]

Islamic banking in Turkey has gained popularity since the election of the Justice and Development Party (AKP) in 2002. Political connections between Islamic banks and the government run high. Finance Minister Kemal Unakitan is a former executive with Al-Baraka Turkish Finance House, and most executives in the bank regulatory agency are formerly Islamic bankers. [REDACTED]

- Turkey hopes to issue an Islamic bond—although it will require constitutional changes to do so—in order to attract Gulf money and appeal to the AKP's Islamic support base, according to a finance ministry official. [REDACTED]

In Southeast Asia beyond Malaysia, the Asian financial crisis of 1997 and the desire to give Muslim minorities better banking options encouraged the political push for IB development. Indonesia is encouraging a greater economic role for IB under the assumption that the financial crisis might have been cushioned had more Islamic banks existed because of their strict criteria for creditworthiness and restrictions on currency speculation.

- Jakarta has issued several regulations to promote IB since 1998, and the central bank is encouraging sector development conforming to a three-stage blueprint that calls for strengthening regulations, promoting IB lending, and boosting IB's international stature. [REDACTED]



- In Thailand, state-owned Krung Thai Bank established Islamic branches, and Bangkok in 2002 ushered through the Islamic Banking Act—which led to the establishment of Thailand's first fully Islamic bank, the Islamic Bank of Thailand in June 2003—in order to better integrate the country's roughly three million Muslims into the banking system, [REDACTED].

#### **Western Banks Getting on the Bandwagon**

Conventional Western banks are quickly establishing IB subsidiaries in the Middle East, Southeast Asia, and parts of Western Europe. In the United Kingdom, in particular, banks, such as HSBC, are lining up to cater to the country's almost two million Muslims.

- An HSBC official reported in October 2003 that the bank's IB funds had reached \$1 billion and that it had 115,000 customers worldwide.
- A major US bank that aims to improve its global Islamic business has established an Islamic bank in Bahrain and has structured more than \$5 billion in international Islamic transactions, [REDACTED].

Western banks may have the clout to garner a significant market share, based on their huge resources and established ties with wealthy Muslims. A hurdle in these efforts, however, will be acceptance by devout Muslims.

- A senior official of the Saudi-based National Commercial Bank (NCB) opined that IB customers would never fully trust Western banks' retail services, [REDACTED].
- Officials at Indonesia's central bank [REDACTED] potential customers of Western banks' Islamic products are unlikely to believe the banks' operations follow Islamic principles. [REDACTED]

#### **Rising Interest in Islamic Assets (U)**

Islamic financial institutions, flush with cash, are looking for places to put their money, prompting a surge of asset-backed Islamic bonds (*sukuk*) and investment funds consistent with IB principles. The rise of IB has spawned interest in identifying equity investment firms that operate in sectors and are managed by values consistent with Islamic principles:

- Malaysia's global Islamic bond issuance in June 2002 was the industry's first. The five-year paper was over-subscribed by 500 percent, encouraging Malaysia to raise the offering from \$350 to \$600 million, [REDACTED].
- The liquidity of Malaysia's Labuan International Financial Exchange (LFX)—a subsidiary of the Kuala Lumpur stock exchange, which provides global listings and trading for a wide range of products including largely Islamic ones—is \$3 billion, with plans to double that this year as 20 new Islamic listings are expected, according to press reporting.
- The former director of the Kuwait Finance House, Kuwait's first Islamic bank, was the catalyst behind a new Islamic investment firm that is drawing in several wealthy Kuwaiti investors, [REDACTED].
- The Dow Jones Islamic Market Index—launched in 1999—tracks *Sharia*-compliant stocks that account for about 1,400 of the 5,200 stocks on the larger Dow Jones index, according to press accounts. [REDACTED]

The corporate sector is also poised to enhance the Islamic bond market. Islamic banking analysts forecast that corporate Islamic bond offerings could grow by some 20 percent annually as Middle Eastern companies shift away from costly traditional bank financing, according to press reporting.

- Large Indonesian firms are already exploiting this market, which a local expert asserts is commercially



driven and pushed by Western banks in the Middle East, such as HSBC. [REDACTED]

Islamic banks have made little effort to break into the US banking market because some US federal laws are not conducive to IB principles. For instance, Islamic mortgage practices would trigger double taxation in the mortgage market.<sup>3</sup> Islamic finance in the UK, by comparison, was boosted in April 2003 with the removal of the double stamp duty on Islamic mortgages, according to press reporting. [REDACTED]

#### **Serving the Poor and Disaffected. . .**

IB is being advanced in part to spur domestic economic development—often where perhaps little or none existed previously—by offering banking services to a broader, less well-to-do retail customer base. Many Muslim individuals and businesses are now using banks, often for the first time.

- [REDACTED] Islamic banks cater primarily to low-net-worth individuals requiring only basic banking services, such as deposit accounts and small business loans.
- A Thai manager of a newly opened Islamic bank branch [REDACTED] that most of his Muslim clients were new to the formal banking sector. [REDACTED]

#### **. . .and Targeting SMEs. . .**

Islamic banks also are gaining ground as intermediaries for small-to-medium-size enterprises (SMEs). Thailand, in particular, has encouraged Islamic banking and IB lending in order to promote economic development for Thai Muslims.

- A long-term goal of the state-owned Islamic Bank of Thailand—established to serve the country's Muslim communities—is catering to SMEs, according to Thai press reporting. Before IB was introduced, some Thai Muslim businesspeople used conventional banks but refused to accept interest on deposits. [REDACTED]

<sup>3</sup> In Islamic mortgages, the bank buys the property and leases it back to the borrower who covers the interest through rent. The bank eventually sells the property back to the borrower. Under US law, the borrower would forfeit taxes and legal fees twice because the property is sold twice. (U)

- Jakarta also promotes Islamic banks to spur lending to SMEs as part of its poverty reduction program, according to press reporting. [REDACTED]

#### **. . .But Also Making Inroads With Affluent Customers**

More recently, IB has begun to attract affluent customers, as well. A senior official at the Abu Dhabi Islamic Bank claimed in May 2003 that the bank was in direct competition with conventional UAE banks for high-net-worth clients who prefer to carry at least part of their portfolio in an Islamic institution. [REDACTED]

- Saudi Arabia's Bank Al-Jazira in March 2004 saw an estimated 60-percent annual increase in activity in its Islamic equity fund, mostly from wealthy individuals. [REDACTED]
- A Saudi financial professional said in June 2003 that his clients—wealthy individuals from merchant families—were increasingly interested in Islamic investments: one large holding company wanted to greatly increase its 25-percent allocation in such products. [REDACTED]

Islamic banks also are tapping into non-Muslim money. Islamic products, while often seen as a diversification play or ethical investments for non-Muslims, are also competitive with conventional products. Non-Muslim investors are the biggest buyers of *sukuk*, according to Qatari press.

- In Malaysia, non-Muslim ethnic Chinese account for about 70 percent of Islamic banks' business, half of the revenue from HSBC's local Islamic subsidiaries, and 77 percent of OCBC Banks' Islamic products, according to press reports. [REDACTED]



**Competition and Nudging To Uphold Progress (U)**

Increased competition among Islamic banks and between Islamic and conventional banks has encouraged the industry to evolve along with the global financial system. Nonetheless, challenges on the regulatory front will require new initiatives on the part of Muslim governments. [REDACTED]

**Differing Approaches Starting To Narrow**

The gap between a more "progressive" interpretation of the tenets of IB and the more orthodox approach is starting to narrow due to the maturing of the industry and competition, including that from conventional banks. The former approach permits more product diversification and breadth in IB, allowing for greater competitiveness and strength.

- For example, a strict IB interpretation would not allow the secondary trading of bonds, interpreted as debt and as creating an unacceptable level of uncertainty. The more moderate approach sees bonds as assets that can be traded on secondary markets. [REDACTED]

Malaysia's less strict approach to IB is slowly taking hold in the Middle East. Malaysian officials note that in the last three years Islamic scholars have warmed to Malaysia's approach—Islamic bonds are now traded at nominal value and intangible assets can partially support an underlying Islamic bond in the Middle East. [REDACTED]

- A Malaysian official [REDACTED] that Kuala Lumpur was able to convince Qatar to issue its asset-backed *sukuk* in the LFX earlier this year. [REDACTED]

Increased competition is encouraging some backlash at the conservative approach in the Middle East. Some Gulf bankers perceive conservative *Sharia* boards, which monitor bank activities to ensure compliance with Islamic law, as a hindrance to bank functioning and profitability.

- Senior NCB managers complained in December 2002 that the bank's "lax and unimaginative" *Sharia* board was crippling competitiveness against

Al-Rajhi and Kuwaiti and Malaysian Islamic banks, [REDACTED].

- Al-Rajhi Bank was very active in the precious metals market by May 2002 because it was the only actual investment the *Sharia* board allowed. [REDACTED]

**Regulation Challenges Growing**

Many countries have improved in regulating and scrutinizing Islamic banks, largely due to prodding from Washington. Most countries with Islamic banks oversee them with the same procedures as conventional banks, but IB regulation is struggling to keep pace with the industry's growth. In particular, a dearth in IB expertise is challenging regulators searching for staff capable of overseeing Islamic financial institutions.

- A Western legal advisor to a prominent Islamic bank [REDACTED] in late 2001 that the staff of the Bahrain Monetary Agency—regarded as possibly the best regulator in the region—did not really understand IB. [REDACTED]

**Opportunities and Challenges for the United States (U)**

Islamic banking could present Washington a unique opportunity to support and promote economic development in the Muslim world while simultaneously showing respect and goodwill toward tenets of the Muslim faith. By promoting an open and forward-leaning Islamic financial system, Washington could help foster stronger, more inclusive banking systems in countries where they are weak and where financial intermediation is lacking, especially for small entrepreneurs.

- In the Middle East, such support could be incorporated into the Greater Middle East Initiative (GMEI). The microfinance initiative of the GMEI may gain greater acceptance if it is tied to IB principles and banks.

- A possible partner in any effort to promote IB is the Islamic Development Bank, an international financial institution established to promote economic development and social progress of its members and Muslim communities.
- Encouraging the growth of Islamic mortgages—a very new development in Islamic finance that is trying to shed the image within conservative circles of being similar to interest-based mortgages—may be another way to promote and deepen economic and financial development in the Muslim world.

The United States also has an opportunity to “quietly and gently” encourage the moderate version of IB. Malaysia may be the best partner for the United States given its less orthodox interpretation of the sector, its success in promoting IB, and the industry’s phenomenal growth in the country.

- Possible USG leverage in IB’s early stages may diminish with time, as the private sector becomes more of an industry catalyst.

US-sponsored technical training for banking regulators on Know Your Customer (KYC) regulations would also benefit IB, particularly in dealing with money laundering and possible terrorist financial flows. A senior Saudi Arabian Monetary Authority official in November 2003 said most Gulf Cooperation Council countries would welcome US expertise on KYC regulations.

- The official claimed that KYC regulations in the Gulf region were disorganized and that there was little coordination among Gulf countries.

Ensuring that any funding of an IB initiative would be free of usury interest may be a key challenge for such a plan’s success. Devout Muslims, who probably make up a large share of those facing obstacles to financing access, will be wary of initiatives funded by institutions charging interest.

- A senior Saudi bank official said that no devout Muslim would put money into an institution that received interest in any part of its operation.



## Appendix A

Major Fully Islamic Banks, 2002<sup>a</sup><sup>a</sup>Denotes data through June 2003. (U)

Source: BankScope. (U)

## Appendix B

### Islamic Banking Developments and Milestones

1975	Around 1975, Muslim nations in the Gulf region and Asia, aided by the Islamic Development Bank, an organization fostering economic and social development in the Muslim world, started to offer Islamic financial services.
1975	Dubai Islamic Bank becomes the first Islamic bank in the Persian Gulf.
1977	Kuwait Finance House, created by Amiri decree, becomes the Gulf region's second Islamic bank.
1979	Bahrain Islamic Bank established.
1983	Turkey establishes a legal framework for special finance houses, or Islamic banks.
1983	Islami Bank Bangladesh becomes the first Islamic bank in Bangladesh.
1983	Malaysia's Islamic Banking Act (IBA) goes into effect.
1984	Malaysia becomes the first country in Asia to provide Islamic insurance.
1991	The Accounting and Auditing Organization for Islamic Institutions established.
1992	Banking Act Number 7 initiates Islamic banking in Indonesia.
1993	Bank Islam becomes Malaysia's first Islamic bank.
1993	Kuala Lumpur allows conventional banks to offer <i>Shariah</i> -compliant financial instruments.
1999	Bank Muamalat Malaysia Berhad becomes Malaysia's second Islamic bank.
1999	Dow Jones establishes first Islamic index.
SEP 2001	Bahrain Monetary Agency issues the Gulf region's first tradable <i>sukuk</i> (Islamic bond).
DEC 2001	Malaysian company, Kumpulan Guthrie Bhd., lists first dollar-denominated international Islamic bond on an exchange.
JAN 2002	Pakistan's central bank issues a license to set up the country's first Islamic bank.
JUN 2002	Malaysia issues the world's first global sovereign Islamic bond; \$600-million five-year <i>sukuk</i> .
NOV 2002	The Islamic Financial Services Board established by representatives from the Islamic Development Bank and from the monetary authorities of Malaysia, Pakistan, Qatar, Iran, Indonesia, Kuwait, Saudi Arabia, Nigeria, Sudan, and Bahrain.
MAY 2003	Malaysia's Labuan International Financial Exchange signs Memorandum of Understanding with the stock exchange in Bahrain, paving the way for dual listings of <i>sukuk</i> on both exchanges.
JUN 2003	The Islamic Bank of Thailand becomes Thailand's first Islamic bank.
OCT 2003	Qatar's \$700-million, seven-year <i>sukuk</i> becomes the largest Islamic investment product to date.

Source: [REDACTED] press reporting. [REDACTED]